

## **Rebuilding the Social Contract at Work: Lessons from Leading Cases**

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## Foreword

The world of work is changing, but the traditional structures governing the labor market, in place since the New Deal, no longer serve the needs of workers and their families or of corporations seeking to compete in a global economy.

The mandate of the Task Force on Reconstructing America's Labor Market Institutions is to provide a body of evidence that helps policymakers and practitioners structure a national discussion on how to update the nation's labor market institutions—resolving the mismatch between a fundamentally new economy and a set of inappropriate intermediaries, laws, and corporate practices.

The efforts of Task Force members are divided among three working groups, each charged with examining a particular aspect of this labor market mismatch: the Working Group on the Social Contract and the American Corporation, the Working Group on Low-Income Labor Markets, and the Working Group on America's Next Generation Labor Market Institutions.

The Task Force's Working Group on the Social Contract and the American Corporation met in November of 1998 to discuss case studies of leading firms that have established innovative or enduring structures and processes for joining shareholder and employee concerns. Their discussion informed this paper, written by Thomas Kochan of MIT's Sloan School of Management, by indicating cross-cutting themes and lessons that emerged from Kochan's case studies.

## **Abstract**

Traditional governance systems and employment practices in the United States provide limited opportunities to join directly employee concerns with issues affecting the competitiveness of the enterprise. Instead—by law, custom, or organizational design—strategic decisions and information are made and held by senior line managers and executives, while the impacts of those decisions are addressed after the fact by human resource professionals or by unions in the collective bargaining process.

This paper explores the potential for and limits of what individual firms and their employees can do to adjust to changes in the economic environment that threaten the social contracts governing employment relations—the mutual expectations and obligations that workers, employers, and their communities and societies have for work and employment relationships. Through brief case studies of leading firms, the author describes several of the innovative or enduring structures and processes for joining shareholder and employee concerns that are evolving or have been established. The cases span a spectrum of approaches, reflecting strategies in five large firms: Eastman Kodak, Lucent Technologies, Xerox, Saturn, and United Airlines. The paper also provides a description of the nature of the social contract with employees for two competitors—Cisco Systems, for Lucent, and Southwest Airlines, for United. Finally, it contains an account of the cross-cutting themes that emerged from the cases, as discussed by members of the Working Group on the Social Contract and the American Corporation at a meeting in November of 1998.

## Introduction

This discussion paper builds on the dialogue occurring in the Working Group on the Social Contract and the American Corporation of the Task Force on Reconstructing America's Labor Market Institutions, at the Institute for Work and Employment Research, MIT Sloan School of Management. The purpose of this Working Group is to discuss the potential for and the limits of what individual firms and their employees can do to adjust to changes in their environments that have led to a breakdown in the *social contract* governing employment relations. As the term “social contract” implies, we are considering the *mutual expectations and obligations that workers, employers, and their communities and societies have for work and employment relationships*.

The Working Group's first step in exploring this issue was to use the questions its members raised at the first two meetings to generate a framework for conducting a series of brief case studies of leading firms that have established different structures and processes for joining employee and shareholder concerns. The group subsequently used these cases to support further discussion, identifying lessons learned from these experiences and assessing options for the future.

These cases are not representative of the universe of employment relationships. Rather, they are examples of how leading organizations are attempting to structure positive employment relationships and—where unions represent a company's employees—innovative union-management relationships that are consistent with today's economic environment. They are large corporations that either have traditionally been or recently evolved from organizations in which the “old social contract” was the norm. Thus, they are prototypical examples of firms that have attempted to adapt their social contract with employees in ways that work in the current environment. As such, these firms provide examples of the possibilities and pitfalls of efforts to accomplish such strategies within individual employment relationships.

## **Key Questions and Analytic Framework**

The Working Group decided early on that there was a need to examine how critical developments affecting both shareholder and employee interests are being addressed in corporations today. The group noted that traditional U.S. governance systems and employment practices provide limited opportunities for directly joining employee concerns and the issues affecting the competitiveness of an enterprise. Instead—by law, custom, or organizational design—strategic decisions and information are made and held by senior line managers and executives, while the impacts of those decisions are addressed after the fact by human resource professionals or by unions in the collective bargaining process.

The Working Group agreed that the case studies should focus on two questions:

1. Are the structures, processes, and leadership efforts in these cases effective in addressing the critical challenges facing shareholders and employees today?
2. Are the approaches likely to be successful in achieving a viable, new social contract at work?

The cases include a spectrum of different approaches that have been used to link employee and shareholder interests more effectively. Eastman Kodak represents a firm with a longstanding reputation for assuming social responsibility for its employees (and their communities) that is now redefining its social contract in order to complete in a world in which it can no longer guarantee employment security. Lucent Technologies is a relatively new firm that is attempting to shed its AT&T legacy of bureaucratic paternalism; however, it also inherited both a strong set of leadership values regarding responsibility toward its employees and a relationship with two unions that includes a consultative structure designed to address issues of common concern. Xerox has maintained a longstanding labor-management partnership grounded in a workplace-level employee involvement and teamwork process. Saturn goes a step further in institutionalizing its labor-management partnership by having union representatives share management responsibilities throughout all of the enterprise's levels. Finally, United Airlines provides a case in which the majority of stock is owned by employees

and in which employees and their unions are represented in the governance process through membership on the company's board of directors.

Supplementing these cases are two short vignettes describing the nature of the social contract with key competitors of two of these organizations—specifically, Cisco Systems in the case of Lucent, and Southwest Airlines in the case of United. After presenting each of the case studies and vignettes, several cross-cutting themes that emerged from the Working Group discussion are discussed. These themes indicate the strengths and weaknesses of the current institutional arrangements found in these companies, as well as the inherent limitations of individual firm-employee arrangements.

## Eastman Kodak

Since George Eastman first started the company at the turn of the last century, Eastman Kodak has been one of the most important corporate citizens in the Rochester, New York, community. Over the 1900s, Kodak developed a reputation as one of the leading proponents of welfare capitalism.<sup>1</sup> In fact, the company maintained its reputation for paying high wages and providing lifetime job security into the 1980s. However, during the 1980s, the company embarked on a diversification and acquisition strategy by purchasing Sterling Drug Company and expanding into a wider range of products, such as office copying machinery. Increased competition in its film and camera markets and the subsequent loss of market share led to the replacement of CEO Kay Whitmore with the former CEO of Motorola, George Fisher.

Kodak's case study tells the story of a long-standing company with a reputation for social responsibility earned through its community activities, its implied commitment to lifetime employment, and its high-wage and comprehensive fringe benefit policies. A highly integrated firm, it also performed all of its own R&D, manufacturing, and sales functions. A business press article in 1998 echoed the investment community's criticism of the company for maintaining this integrated model too long:

Many of Kodak's problems stem from the company's remarkable success in the century following its founding in 1892. Unfortunately, as the world changed rapidly over the past 20 years, Kodak remained stuck in its illustrious past. Other wold-class companies were adapting to the new realities of business by forming corporate partnerships, joint ventures and close relationships with suppliers. Yet Kodak always took its founder's slogan, 'You press the button and we do the rest' much too far. The company insisted on preserving its self-reliance to the point of making its own screws and springs and sheet metal. Millions of dollars were frittered away on research with no practical application. Damn the costs, Kodak was determined to be an industrial fiefdom in the 19<sup>th</sup>-century mold (Santoli 1998, 25).

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<sup>1</sup> For a thorough analysis of Kodak's employment and community relations history, see Jacoby (1997).

## Key Events

Several key events serve as milestones in Kodak's attempt to redefine its social contract with employees: repeated downsizings in the late 1980s and early 1990s; the inauguration of a new CEO, who refocused the company on its core product markets; a major restructuring effort to cut costs; and an explicit, new social contract initiative.

### *Repeated Downsizings*

As its market position deteriorated in the late 1980s and throughout the 1990s, the company's lifetime employment and integrated structure and strategy fell under increasing pressure. At first, the company resisted the push to make major changes and instead undertook periodic downsizings that slowly eroded Kodak's lifetime security promise.

The layoff decisions made in the 1980s have been criticized for their poor execution and lack of overall vision. Layoff decisions were often based on an employee's most recent performance review, meaning recently hired talent was lost. A "one-time" buy-out program offered in 1983 was designed to reduce staff by 3,100; 5,000 employees accepted the offer. What was expected to be a one-time cut was followed by additional downsizings in 1986 (12,000), 1989 (4,500 announced as the target; 6,000 actually left), 1991 (3,000), and 1993 (10,000).<sup>2</sup>

### *The New CEO: Refocusing on Core Products*

George Fisher's first strategies upon arriving at Kodak in 1993 were to grow the company out of its problems by focusing on its core film and imaging business and to implement at Kodak the disciplined, quality-focused manufacturing processes he presided over at Motorola. By 1995, however, further downsizing was announced—and this time 4,000 jobs were cut. Still, Fisher stopped short of a major restructuring.

In the mid 1990s, the company decided to refocus more narrowly on its core markets for film, cameras, and emerging imaging technologies. It sold Sterling Drugs

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<sup>2</sup> For a review of Kodak through the 1980s and 1990s, see Swasy (19XX).

and completed the separation of Eastman Chemical into a separate company. It also created a number of joint ventures or partnerships with firms such as AOL, Picture Vision, and a consortium of four other companies working to develop an “Advanced Photo System” for linking images and magnetically embedded information on negatives.

### *Major Restructuring Efforts and a Focus on Costs*

By 1997, under considerable pressure from investment analysts, Fisher and his management team realized that the company could not grow out of its competitiveness problems. At the same time, Kodak also faced major price competition from its biggest international competitor, Fuji, which was engaged in a major price-cutting campaign aimed at increasing its market share internationally and particularly in U.S. markets. In response, Kodak made more significant changes designed to reduce its costs and to recapture market share in the company’s core products.

As part of the restructuring effort, Kodak estimated that 19,000 jobs would be eliminated over the course of two years. The company also recruited a new set of senior executives and staff professionals. Hiring top leaders from outside the firm represented both another departure from Kodak’s traditions and a signal of its leadership’s determination to change both the culture and the performance of the company. According to one executive who examined the employment options open to the company when he first arrived at the firm in 1996,

[t]he company waited too long to make the hard decision to downsize the workforce to where it should be. If it had taken the hard action sooner, everybody—the shareholders and the employees—would be better off today. But it was very hard to make these decisions, given the community scrutiny and impact this company has carried over the years.

The company’s manufacturing operations became a central focus of attention and change. Once again, the 1998 business press offered commentary, this time in a more approving manner:

The cost-cutting crusade is at the core of all other business improvements under

way at Kodak, and it's heartening to investors that Kodak executives stress that eliminating waste is not a temporary preoccupation. Removing costs 'is a relentless, forever thing,' Fisher insists. 'The trick is to take costs out and grow the business.'

Taking on the role of cost-cutting czar has been Eric Steenburg, a 27 year Xerox veteran who was brought on. . . in the position of assistant chief operating officer. . . . Steenburg found a wealth of savings opportunities. He consolidated the office and business imaging segments, sold some non-core units, trimmed the number of vendors, reorganized procurement across the world, reduced inventory costs and is helping to oversee the installation of anew global software system from Germany's SAP.

Steenburg is improving manufacturing processes using the vaunted Six Sigma quality-assurance process, and he is moving labor-intensive manufacturing operations to locations like Tijuana, Mexico, while keeping capital-intensive work near Kodak's base in Rochester, New York. Some Kodak products are now being manufactured by outside contractors (Santoli 1998, 26-27).

### *The New Social Contract Initiative*

An important feature of the company's restructuring efforts involved a series of speeches and related efforts by Fisher to redefine what the CEO has called its "new social contract" with the workforce—one that is responsive to the realities of the market (Fisher 1997).

Fisher uses the term "social contract" to describe the "new deal" that the company wishes to make with its employees, promising employees 40 hours of training and career development per year and holding supervisors accountable for ensuring that their employees receive this amount of training. Regular surveys of employee satisfaction are to be conducted and supervisors' bonuses are to be tied to their results.

Fisher believes the following outcomes will result from the initiation of this new contract:

The benefits for the employees are many. Over time, creating a new relationship with employees should lower workplace anxiety, close the chasm of fear and cynicism and rebuild trust—another one of our core values. Employees will be more marketable, more 'in demand.' They will become leaders in an environment where everyone is expected to be a leader. Each will become responsible for the success of the business. Each will learn to take risks, be innovative, and not be afraid of failure for taking reasonable risks (Fisher 1997).

Fisher also sees the modern firm as being responsible for aligning the interests and meeting the goals of three different stakeholders:

To build for growth, the new relationship should create pay-for-performance cultures driven by a set of well-articulated company values and goals. At Kodak, as at most companies, our goals are customer satisfaction, employee satisfaction, and shareholder satisfaction. Customer satisfaction drives growth and profits, which lead to shareholder reward and satisfaction. But we cannot serve customers and create value for shareholders if we fail to achieve employee satisfaction. Each corner of the triangle is essential to build a pyramid of success (Fisher 1997).

### **Summary and Implications**

The Kodak experience demonstrates that the vision and values of the CEO matter significantly, but that even a CEO who wants to carry on the tradition of being a socially responsible employer can no longer do so in an old-style, paternalistic fashion or with a full-employment guarantee. As a human resources (HR) executive (from another company) put it: “Nobody is saying that they will provide lifetime jobs any more, and no employees would believe it anymore if it was said.”

As a “new socially responsible” firm, Kodak is now is defining those responsibilities around three key points:

1. Cushioning the effects of job loss by using early retirement, severance packages, job search assistance, extended health insurance coverage, and other means of aiding those downsized in transitioning to another job or into retirement.
2. Redefining the new social contract at work as one in which the firm will provide opportunities for continued learning and education for employees to keep their skills current and marketable in the external labor market, as well as within the firm.
3. Communicating openly and honestly about the competitive realities of the business and rewarding employees for their contributions to firm performance.

The future of employment relations at Kodak, therefore, will depend on how

successful the company is in regaining market share and penetrating new markets related to film processing and imaging technologies. While the company believes that, once it completes the large-scale downsizing announced in 1998, it will have the proper level of employment, it will clearly continue to restructure its manufacturing function as productivity is improved and labor-intensive work is outsourced to lower-cost domestic or international firms. How a new social contract—based on the three principles listed above—is received by the workforce will likely be determined by whether the downsizing is completed and the company continues to improve its market share and financial performance.

## Lucent Technologies

**L**ucent Technologies, Inc., was created in 1994 by the tri-vestiture of AT&T. The new company consists of the former Bell Labs and AT&T's network systems development and manufacturing business. Lucent designs, manufactures, and services public and private networks, communications systems, communication software, data networking systems, business telephone systems, and micro-electronic equipment. Bell Labs provides the company's research and development function.

Lucent's growth over its first four years has been impressive. At the time of AT&T's decision to spin-off Lucent, the subsidiary employed a staff of 138,000. When the spin-off occurred, AT&T announced its intention to downsize 40,000 workers, including approximately 23,000 from the operations that were to become part of Lucent. The belief was that the stock market would react positively to this announcement; however, to the surprise of all, a strong negative public reaction was indicated, including a critical cover story of the decision in *Newsweek*. The downsizing did not, in fact, occur. By 1998, Lucent employed 140,000 people worldwide, 100,000 in the U.S. (45,000 unionized) with worldwide revenues in excess of \$26 billion.

Lucent is also the successor to two AT&T bargaining units: the Communications Workers of America (CWA) represents 25,000 sales, installation, and repair workers; and the International Brotherhood of Electrical Workers (IBEW) represents 19,000 manufacturing employees. As part of the tri-vestiture agreement, a labor-management consultative structure negotiated and implemented at AT&T in 1989—called “Workplace of the Future”—was carried over into Lucent's contract.

### Critical Events and Issues

Three developments dominate Lucent's history to date, as well as its future: (1) the creation of the new company and the values and legacies inherited from AT&T, along with the values and strategies favored by the new leadership team; (2) the reorganization of the company into 11 business units and the roll-out and

communication of a new business strategy under the acronym “GROWS”; and (3) the favorable overall employment relations experienced by the company to date, particularly among its professional and managerial ranks, along with some significant future challenges that the company and its hourly workers and their unions face.

### *Lucent's Formation*

Henry Schacht was appointed as Lucent's first CEO. His vision was not to make piecemeal changes to shed the AT&T legacy and culture but to realize a wholesale shift from a manufacturing-driven to a technology-driven, high-performance enterprise. According to one Lucent executive,

AT&T was a lumbering bureaucracy. It missed a whole generation of technological change in our business. We are still feeling our way in changing the culture from the bureaucratic, process and procedural and hierarchical nature of AT&T to a quicker to respond type of company.

A decision by Schacht and his fellow senior managers not to participate in the IPO (initial public offering) until all employees were eligible to buy stock in the new company was noted by the workforce as a symbolic indication of the values that the company's leadership wanted to instill in the organization. One employee expressed this sentiment in his response to a survey question asking what people or events in Lucent's history had made the biggest impact on its culture and the treatment of employees:

[It was] Henry Schacht announcing that the leadership team would not take any stock form the initial IPO, but would instead wait until stock could be made available to all employees. The leadership team left a lot of money on the table to make a statement that we were all in this together.

Richard McGinn succeeded Schacht as CEO and Chairman in 1998. McGinn ran network systems at AT&T; he shares Schacht's vision for the company and continues to follow the first CEO's strategy.

The greatest technological challenge facing the company is a movement from voice-based to data-based switching technologies. Lucent's 5E switch currently dominates voice-based switching technologies and provides a major source of cash

flow. Yet, voice-based switching may be obsolete in five or ten years. Cisco Systems is Lucent's primary competitor, focusing on data-based switches, and is perceived by most experts inside and outside of the company to be far ahead in the development of this technology.

Thus far, Lucent's strategy for catching up to competitors like Cisco has been to acquire companies that have strengths in different areas of the emerging technology. In its first three years, the company purchased several small high-technology firms such as Prominet, Agile, and Yuri, while selling other units such as its defense-related Advanced Technology Systems unit. More and larger acquisitions may come in the future since, after Oct. 1, 1998, certain accounting restrictions that Lucent inherited from tri-vestiture have expired. This development will lower the cost of acquiring other firms, since Lucent was formerly required to include goodwill on its current expense and income statement.

Lucent's human resource (HR) professionals are consulted before and after the decision to make a major acquisitions purchase. Prior to the purchase, HR staff are asked to assess the firm's compensation system to determine the true cost of buying the business. After the purchase, HR's major task lies in integrating the company and its compensation system into Lucent's, without losing the key technological talent embodied by the firm. An HR executive characterized this issue in the following way:

When we buy these firms, we are buying the technology and the people, and we have to make sure we don't lose the key people. How to do it? They don't want to work for a big bureaucratic company. They don't expect to stay with one company for 30 years so a pension is meaningless. They want 401(k)s and equity-stock options.

Thus, Lucent is very focused on the need to attract and retain the key "knowledge workers" needed to develop the technologies that are critical to its future. In fact, the emphasis on innovation and growth are evident in numerous comments employees offer on the various bulletin boards and other intranet communications outlets available to them.

### *Reorganization to the Business Unit Structure*

In September of 1997, Lucent reorganized the company by creating 11 business

units from the four it had previously. Accompanying the reorganization was a major strategic initiative that uses the acronym of “GROWS” to convey the key elements in the company’s strategy for the future. GROWS stands for the following strategies:

- Global: 70 percent of the company’s future growth is expected to come from outside the U.S.
- Results: Customers are demanding different, customized products to meet their different needs. This translates into the need for improved productivity, especially relative to the benchmarks set by newer, smaller, and more flexible firms in the industry.
- Obsessed: Obsessed with a focus on customers and new competitors.
- Workplace: The goal is to promote an open, supportive, diverse workplace.
- Speed: The bureaucratic traditions of the company need to be replaced with a technology and innovation-driven culture.

The reorganization decision was made in October of 1997 and then announced two months later to industry analysts at a December meeting. The announcement was followed by a series of employee meetings, but the restructuring itself was not guided by direct input from HR executives. Instead, the need to increase the autonomy of different businesses and their responsiveness to changing markets drove the decision. So too did the desire to change “systems and processes”—moving from being a high-cost producer to implementing a new business model that focuses on developing technology and delivering it to customers, not on manufacturing. As one executive put it,

We don’t think of employees when making these decisions. These decisions are driven by ‘processes and structures.’ Once the decision is made, then HR is asked what to do about the people issues.

We went through a big educational effort after the reorganization was announced. PR created a package that became known as the “meeting in a box” for managers to use in talking with employees that discussed all the issues—why we made the changes, the business issues we face, etc. But this communication was not really effective. It didn’t create a revolution. McGinn made some factory visits that culminated in April in an all-employee video.

The video created a problem for labor relations because it celebrated all of the company's accomplishments. It pointed up a classic dilemma—for the analysts we need to emphasize all the positive accomplishments and paint a bright picture. Then we go into labor negotiations and ask for changes and the employees say but the company is doing just fine so why should they agree to what they see as concessions or to items on the company's agenda. All the employees heard from the video is that that we are doing great.

### *Current Employment Relations and Future Challenges*

Lucent is enjoying a very high and improving level of employee morale among professional and managerial employees. These good feelings are likely a product of the strong growth experienced since the formation of the company; its emerging image as a leader in technology; the values embodied in the leadership of Schacht and McGinn; the very comprehensive set of human resources and labor relations policies and benefits inherited from AT&T; and the offering of stock options to all employees, which grew in value as the company's stock increased over 500 percent from the time of the benefit's implementation. The company was confident enough in its policies and employee relations climate to apply for inclusion in the competition for the "100 Best Companies to Work for in America."

Lucent also enjoys a particularly strong reputation and success record in recruiting, promoting, and retaining minorities and women, as well as in maintaining its commitment and successful approaches to managing the diversity of its labor force. HR staff place managing diversity as one of its highest strategic priorities and, through the Senior Vice President for HR, has been successful in making diversity a top priority in the company. Supporting this high-level commitment are seven "Employee Business Partner" groups that serve as community-building networks for different race, gender, or identity groups. These groups hold annual meetings and form regional chapters; have their own websites; support efforts to recruit, educate, and train the workforce; and foster a sense of community among their members.

However, for labor relations involving hourly employees, the future is full of challenges and uncertainty. The primary threat lies in the fact that most of Lucent's competitors (see the next section, which features Cisco Systems, Lucent's key

competitor) outsource their manufacturing operations to smaller firms with significantly lower cost structures, thereby placing similar outsourcing pressures on Lucent. The average age of Lucent's unionized workforce is 49, with 25 years of service. Employment in manufacturing has been stable in recent years. Whether these employment levels remain stable or decline will depend on how the company and unions deal with the following interrelated factors: opportunities and pressures to outsource commodity components and installation work now available from lower-cost suppliers; competition within the company between R&D and manufacturing units for scarce capital dollars; the rate of growth in market demand for Lucent's products; and the changing skills needed to perform high value-added manufacturing work.

Costs are also part of the equation, but do not serve as the primary driver for deciding the future of Lucent's manufacturing operations. The company estimates that it has a 15 percent wage and 20 percent benefits premium over its manufacturing competitors. In addition, it has a large pool of retirees whose health costs must be charged against current income—while many of its competitors do not yet have any retirees to support. Thus, labor costs are one variable affecting sourcing decisions. However, since labor costs represent only roughly 10 to 15 percent of total costs, closing the 20 percent difference would produce only a 2 to 3 percent reduction in total costs.

The need to allocate scarce capital to research and development (R&D) is likely to be a more important factor. Some of the company's products have a very short half-life—less than one year, in some cases. As a result, R&D must be a high priority for capital investment decisions. When Lucent was formed, it promised the investment community that it would focus on five metrics: improving gross margins, growing sales, reducing its tax burden, reducing overhead, and continuing to invest at least 11 percent in R&D. One Lucent executive described the reluctance to invest scarce capital dollars into an expansion of manufacturing capacity:

We've been growing by 20 percent a year and we project the continued growth at this rate for the next several years. But we know that this type of growth rate is not sustainable indefinitely and so we are reluctant to continue to add manufacturing capacity that someday we may not need. So to meet this growing

market demand for our products, we need to allocate and focus existing manufacturing space on core competency activities where we are adding value.

Let me give you an example. For many years, we manufactured “circuit backs” because these were part of our core technology. More recently, surface mount technologies have made circuit backs a commodity that can be purchased from any number of suppliers—our processes are no longer unique. So it makes sense to outsource this work. By outsourcing commodity work like surface mounts, we can make room for the high value-added work needed to support our current rate of growth. If we do this well, when we net it all out, we may not see a decline in the number of manufacturing workers, but a change in what they do.

This is why continuous learning and training is so important. We have to make sure our workforce can do the high value-added work and is prepared to take on the new work as it comes along.

Next week our CEO and Strategic Management Group will meet with union leaders to discuss this and go over this approach.

This is the key labor relations challenge we face and this is why we wanted five years in the new agreement [negotiated in the summer of 1998] to work on this. If we don’t solve this problem we will be in the exact same place in five years that GM and the UAW found themselves in this summer—fighting in negotiations a fruitless battle over how to deal with pressures to outsource because we are by far and away the high-cost producer in our industry.

So our legacy of labor relations and how we solve problems has to change. We must involve everybody—from the grassroots up—this is what we have to change in our culture. We have to turn our unions and employees into a positive contributor to our business performance.

The Workplace of the Future structure we inherited from AT&T hasn’t worked. The unions treat it as just another forum for bargaining—we tell them about plans to expand in Venezuela and they respond that they therefore need to get more jobs in the U.S. And our executives treat it just as a contractual obligation—they give it lip service and go through the motions but see labor as a constraint on their actions and an interference in their businesses.

The basic problem is that nobody connected the GROWS strategy to Workplace of the Future—there is lots of anxiety over GROWS, not knowing what to do with it and how to bring it to the factory level.

Our senior managers have been reluctant to get involved in labor relations. Their attitude is: ‘You handle that.’ Moreover, very few of the business unit managers have ever had any experience in dealing with or managing with a union—little factory floor experience.

Both union and company representatives realized that the Workplace of the Future structure needed to be rejuvenated and agreed to discuss how in their 1998 negotiations. Out of these deliberations came an agreement to take more of a bottoms-up approach to the process. A labor relations executive for the company described the new approach:

We need to start at the locality—go where the problems are and put more emphasis on employee involvement and training supervisors and go from there. We have to do so recognizing that there is not a lot of room in our contracts for improving productivity—our contracts are pretty good. If we are to improve productivity we have to do it through employee involvement. Management and the unions agree on this and we are all behind this effort.

Union leaders, however, are skeptical and in some cases feel betrayed by management decisions to outsource work without prior discussion. Several repeated instances of outsourcing led CWA local and national representatives to meet to discuss how to address what they saw as a clear deterioration in their relationship with the company—what some viewed as a “betrayal” of the principles required to sustain any form of a labor-management partnership. The top CWA leader responsible for relations with Lucent described the situation in the following way:

The participatory effort is just about to snap apart. Within the past three months, the company did three things without prior consultation with us that indicates they are not serious about a partnership.

In September they subcontracted work done by our installations technicians—high-tech work involving the 5E switching machinery—done for Bell System companies. We have hand-billed Southwestern Bell (SBC) asking them why they are paying top dollar for service that is sub-standard. We intend to do more of this.

In October they informed us of their intent to franchise out more work done for Bell companies.

In November, they informed us they intend to outsource a lot of manufacturing work—there will be no layoffs because there is 17 percent attrition per year, but this will mean a reeducation of this many CWA jobs. Again, no discussion—just notification.

All this flies in the face of what we agreed to work on in negotiations—we agreed to address how to make something of Workplace of the Future offline, outside of the negotiations.

Our members are really angry. I just came from a week of meetings with them about this in Miami and they feel there is no loyalty left with Lucent. They have not loyalty to us so we shouldn't give any to them. Workers feel betrayed, especially because the company is doing well and they see the top people at Lucent doing very well. The inequity really gets to them.

At the time this case was written, the labor-management relationship was to be determined by whether Lucent's top executives chose to revive and reinforce the Workplace of the Future partnership and limit the flexibility of business unit executives to reduce costs by contracting out manufacturing and installation work that would otherwise have been done by bargaining unit employees or whether to continue pressuring business unit leaders to lower costs and give them the flexibility to make whatever sourcing decisions were necessary to do so. If the latter option was chosen, the corporate labor relations professionals would have been placed in an untenable position of not having the ability to share information and find solutions to potential outsourcing problems before they occurred. Instead, they would have become the messengers of bad news after the fact, in ways that would have demonstrated their lack of real power in corporate decision-making. To sustain the partnership, top executives would have had to choose between these two alternatives.

## **Summary and Implications**

Lucent is a technology-driven company that competes with new and smaller firms that focus on developing and packaging new technologies and outsourcing manufacturing to low-cost, non-union producers. It is behind its key competitor in the emerging data networking technologies that will dominate domestic markets in the future but continues to sell large quantities of the voice networking switches (5E switch), which have served as the company's biggest source of cash flow. Lucent also inherits a bureaucratic culture and is trying to shift to a technology-driven, innovative culture.

HR has not been centrally involved in the company's key strategic decisions, with the exception of technical issues associated with costing and merging compensation and benefit programs of potential and realized acquisitions. However, the need to attract and retain the "knowledge workers" who are critical to the development and use of emerging technologies serves as a strong incentive for the company to build and maintain a culture and comprehensive set of HR practices that respond to the needs and interests of this segment of the workforce.

Seventy percent of the future growth in the markets for the company's products is projected to come from international—not domestic—markets. Competition for capital investment resources will be intense, with strong incentives for focusing spending on global opportunities and developing new technologies, as well as for strategic acquisitions of companies that have the technological, human capital, or customer assets critical to leapfrogging Lucent's competition. Few incentives exist to invest in the company's manufacturing capacity, given market uncertainties, the need to allocate capital to R&D, and the availability of lower-cost manufacturers to which commodity components can be outsourced.

Lucent has an aged unionized workforce focused in manufacturing (IBEW) and in installation and service (CWA). Union membership has been stable since the tri-vestiture, but future trends are uncertain and could be on the decline, particularly as pressures to outsource manufacturing intensify. How employment trends eventually play out is likely to be a function of the net effects of efforts to grow the business, outsource commodity components, and focus on high value-added work and technologies.

The company and the unions have a structure for consultation around strategic issues—the Workplace of the Future—that was inherited from AT&T, but that structure is not working well. In fact, its future depends on the success or failure of the newly agreed-upon strategy for emphasizing a more bottoms-up approach, based on a foundation of employee involvement and an articulation of the relationship of the company's GROWS strategy to specific units.

The CWA national leadership is open to discussing new approaches to union-management relations that reflect the company's efforts to move toward more of a

network structure. The IBEW is still more reluctant to do so. Local leaders, however, are less open to or ready for a change. In addition, top executives are not motivated to grapple with labor relations issues or relationships and have little experience working or dealing with union representatives.

The respective parties have five years before their most recent contracts expire. What occurs during this window is critical to avoid being backed into a corner, similar to the GM-UAW problem of being the high-cost and most integrated producer in an industry that is following a business strategy of outsourcing manufacturing and forming alliances or joint ventures with other firms.

Given these dynamics, I draw the following lessons from this case:

1. There are two worlds of employee relations at Lucent—one for professional, technical, and managerial workers with the knowledge and skills needed for the company to grow, develop new technologies, and succeed in the expanding international markets the company projects; and another for the hourly labor force, particularly those in manufacturing, who are facing employment security threats from lower-cost competition.
2. Structural forums for consultation and representation are not enough; Workplace of the Future was designed to deal with exactly these types of issues but has not been able to do so. Both a vision and strategy for such structures and processes must be shared by line managers, senior executives, labor relations managers, and union representatives at both the corporate and business unit levels.
3. Unless the basic business plan changes or there is a change in the relative costs/productivity of internal and outsourcing alternatives, hourly employment and union membership are likely to decline. One scenario for the future is that the company will gradually wind down union membership through attrition. If this path is followed, an important question is whether the deterioration in the labor-management relations that is bound to occur will lead to further conflict or cost problems, since the unions representing Lucent employees will lose substantial membership under this scenario.
4. A second alternative is that the restructuring of manufacturing around high value-added work that reflects the company's core competencies, along with market growth, will make up for the jobs lost by outsourcing lower skilled work to outside manufacturers.
5. Another alternative is for the unions to change from a company to a network strategy—developing a way to organize and represent workers across all the firms that participate in the value chain. To do this, however, would require

a different union model, one that follows individual workers and work as well as overcomes the strong resistance toward supplier firms.

For the network strategy to succeed, unions must train and supply the skilled workers needed to install and maintain the data-based technologies of the future, in the same way that a craft or professional union not tied to a single firm would do. This strategy would allow the firms themselves to compete, while the union provides the workforce to whomever emerges with the dominant market share. To accomplish this goal, however, requires a new approach to training and development of workers' skills, the portability of benefit and pension packages and more individualized services, and an industry/occupational strategy that crosses firm boundaries.

## **Lucent's Competitor: Cisco Systems**

**C**isco Systems is a rapidly growing high-technology firm specializing in designing networking systems that link computers and provide Internet communications. It is a major leader in the development of data communications switching technologies and, therefore, Lucent's key competitor. Cisco was founded in 1990 and has grown very rapidly in size, profits, and stock value. Its 1998, revenues were \$8.5 billion. Cisco employs approximately 15,000 people, 3,000 of whom are contingent employees—either agency-hired temporaries or independent contractors (approximately 800). The company contracts (or “partners”) with outside firms for most of its manufacturing. It has grown mostly through acquisition, purchasing approximately 24 companies during the eight years between its founding and May of 1998.

From its start, Cisco's human resources strategies have served as an important component of its competitive strategies. The key features of these human resource strategies and their links to competitive efforts are summarized below based on an interview with Ms. Barbara Beck, Senior Vice President for Human Resources.

### **Strong Culture and Values**

The founders of Cisco brought with them a strong passion that was embedded in the firm's culture from the beginning: a focus on the customer. Early on, a senior member of the staff convinced the company's leadership to call him the Senior Vice President for “Customer Advocacy.” The importance of customer satisfaction is reinforced in Cisco's reward system—a portion of every employee's bonus is linked to customer satisfaction with the company overall, as well as customer satisfaction related to an individual's performance.

From its inception, Cisco's founders have emphasized a desire to establish a different kind of relationship with its employees. The question was how to realize this goal while building the company's competitive advantage. The answer was to emphasize the effective building and use of its intellectual capital inside the

organization and of partnerships with organizations external to the core intellectual capital in which the firm would specialize. As a result, the firm outsources most of its manufacturing to external “partners.”

### **Bonus and Stock Option Plan**

As Beck indicated, Cisco hires “knowledge workers to transform industries. So our company philosophy is to share rewards and risks. We pay low base salaries—about 65 percent of the industry average. Bonuses are paid on the basis of firm performance relative to the industry and on customer satisfaction.”

All employees receive stock options when they are hired and receive additional options based on their performance. Forty percent of the outstanding stock options are held by non-managerial employees. The options represent a substantial amount of money, since Cisco stock has increased over 500 percent and has split at least once in its history. Many employees have amassed a great deal of wealth by staying with the company.

### **Growth Through Acquisitions**

“Technology is changing so fast we can’t develop it all,” said Beck. “So we fill out our development with acquisitions, especially when a new technology is emerging that might now or in the future fit in with or enhance our products. We buy it even if it is perhaps only 80 percent likely to be the “right” or “best” technology out there. That has been a conscious decision right from the start. Our software engineers like to say that six months is a long time—some of the technologies they work with are obsolete in that time frame.” As a result of this strategy, Cisco has made 30 acquisitions in 5 years to ensure they have access to the next-generation technologies that fit their product lines.

## **Cisco's Social Contract**

What is the social contract that Cisco offers its employees? Beck indicated that Cisco does not want to be a “model employer” for every type of workers. Rather, it wants to be a model employer for those who match its organizational culture. Cisco works hard at recruiting employees who fit their mold, with a strong interest in:

1. Ownership and profit-sharing;
2. Intellectual stimulation, with “great people to work with and projects to work on”
3. Integrity, ensuring fairness in how they are treated;
4. Pride in the work they do and the products they develop; and
5. Wanting to work for a company that has visionary leadership.

As Beck explained,

I don't believe you can generalize our relationship to all companies because we are so selective in hiring people who can make a difference here. But the difference is more likely to be across companies, not age groups. Our survey data show no differences of importance on attitudes and values across age groups, including Gen-Xers. We want to make Cisco a great place to work for people who want to work here—those who fit into Cisco's culture.

## **Role of Contingents**

Currently, Cisco utilizes about 2,300 agency temporary employees and 800 contractors. Given the laws governing these contingent relationships, the management of these relationships poses difficult problems.

The laws on this were designed for an industrial age. Now companies like ours manage differently. We have a high level of uncertainty in the number of new hires we need to make in any period and we only want to hire people we know we will not have to lay off. So we use contingents to buffer the uncertainty and variability in demand. Moreover, lots of people want to work for multiple companies. For example, we use independent contractors as recruiters. These people are great—they are effective in finding the right people for us and they don't want to become regular employees. We also bring in people to do specific project work—peak jobs that we are not sure will last beyond the project. But

the tax law, and the recent Microsoft case are forcing us to redefine some of these people either as temporary employees (they have to now go through an agency) or as regular employees. So we put in ‘gates’ to decide who belongs in which category, and many of these people are very unhappy about losing their contractor status. This is a major source of frustration for us and for these people. Many want the flexibility.

## **Summary**

Cisco is a newly emerging high-technology firm that is benefiting from rapid growth—and the types of human resource policies that rapid growth and rapidly increasing profits can support. It has developed a niche, where it promotes innovation by providing an environment conducive to attracting and retaining knowledge workers; the company’s core competency is, in fact, the technology and people it develops and acquires. Cisco has a value system that emphasizes partnerships and win-win outcomes—for shareholders, customers, employees, and firms with which they contract. Their compensation system is designed to align the incentives of the workforce with those of the shareholders and customers. They recruit and select individuals that are attracted and can contribute to this culture and to the shared vision of “transforming” industry through their products and technologies. The fantastic growth and profitability of the company reinforces its culture, keeps turnover very low by industry standards, and has produced a large number of very wealthy employees.

The firm contracts out many of the manufacturing and service activities that older industrial firms would have done in house, allowing Cisco to retain its focus on knowledge workers and the acquisition of new technologies. It uses independent contractors and temporaries to buffer the uncertainty of demand and to cope with peaks and valleys in the projects associated with product development and delivery. The company is frustrated with the laws governing these employees, because it has had to reclassify some valued independent contractors who want to retain that status as temporaries.

Human resources strategies are both very important to this firm and highly integrated with its core competitive strategy, the acquisition of new firms, technologies, and people. Its compensation and reward strategies and the culture the company has

built are also critical to maintaining the environment needed to attract the types of workers who will allow the firm to stay on the cutting edge of changing technologies and markets in its industry. Its social contract therefore focuses on providing a financially and psychologically rewarding place to work.

## Xerox

The Xerox Corporation employs approximately 150,000 workers globally and 90,000 in the United States. Within the United States, approximately 4,000 manufacturing employees are unionized, with the vast majority located in Xerox's main manufacturing center in Webster, New York, a suburb of Rochester. This case will focus on the partnership that Xerox has with its union—the Union of Needletrades, Industrial, and Textile Employees (UNITE). We focus on this partnership because it is perhaps one of the most longstanding and successful labor-management partnerships in the country, as well as one that many researchers have been following since it was initiated.

The Xerox-UNITE<sup>3</sup> partnership began in 1980, when the company and union negotiated an agreement that provided for experimentation with employee involvement. At roughly the same time, Xerox implemented a major top-down Leadership through Quality initiative. Over the years, the bottom-up and top-down efforts were effectively integrated and continue to provide a shop-floor training and participative work system at Xerox. From a narrow employee participation process, the labor-management partnership expanded to support development of work teams, special study teams to address outsourcing decisions, self-directed work groups, and joint approaches to new facilities.

Five successor collective bargaining agreements have been negotiated since 1980, the most recent for a long-term contract lasting from 1994 to 2001. That agreement proved to be controversial both within the company and the union. It provided for a set of new, lower-wage classifications for several entry-level positions and the flexibility to hire more temporary workers, but in return for the continuation of guaranteed employment security for incumbent workers through 2001. Amidst these negotiations were rumors that some management officials were exploring the option of moving much or all of the company's manufacturing operations from Rochester to

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<sup>3</sup> UNITE is a merged union. The partnership was originally formed by Xerox with the Amalgamated Clothing and Textile Workers Union (ACTWU). In 1995, ACTWU and the International Ladies

North Carolina and other operations to Mexico. The company's decision to negotiate a long-term agreement signaled the defeat of the North Carolina option and a commitment to maintain operations in Rochester, at least for the duration of the contract.

In addition to the shopfloor partnership, Xerox executives meet twice a year to share information with top union leaders over the current and future state of the business.

### **Key Events: 1980-Present**

The Xerox-UNITE partnership has been described and summarized in various places and is well-known to those in the field of employment relations. Therefore, I will only summarize the pivotal events and developments in the relationship since its formation in 1980. A full case study (used for teaching purposes) is available for those interested in exploring the partnership in greater detail.<sup>4</sup>

#### *1980-82: Employee Involvement Program*

In 1980, the company and union included a clause in their collective bargaining agreement calling for an employee involvement (EI) program. The agreement included a provision indicating that nothing done in EI would in any way change other management rights or union-negotiated work rules. Thus, at the partnership's outset, EI was viewed as a limited quality circle program. The initial program was well-received by the rank and file and by plant managers.

#### *1982: Wiring Harness/Outsourcing Issue*

The first crisis in the program came in 1982—when, as Xerox's market share hit the bottom of a decade-long decline and the push to reduce manufacturing costs was acute, the union was informed the company planned to outsource its wiring harness

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Garment Workers Union merged to form UNITE.

<sup>4</sup> See "Multiple Perspectives on Organizational Transformation: The Case of Xerox Corporation,"

operations. The company estimated that an annual cost savings of \$3 million would result from outsourcing this work. After some discussion, a joint committee was established to examine whether production changes could allow this work to be done competitively in-house. The result has now become a classic example of how EI can—if allowed to do so with mutual consent of the union, company, and workforce—take on broader and bigger issues. The committee recommended changes that would reduce manufacturing costs by more than the \$3 million benchmark. However, the changes involved a number of contractual rules and managerial prerogatives. The company and union agreed to these changes, modified their labor agreement to accommodate them through a series of side letters and language changes approved in the subsequent contract negotiations, and most importantly agreed to institutionalize this approach for handling future outsourcing decisions.

### *1983: Negotiations*

The second crisis came in 1983, when the parties renegotiated their labor agreement amidst the success of EI and the wiring harness outsourcing decision, as well as layoffs of both the blue and white collar workforces that had occurred in the previous year. Surveys and company data both clearly indicate that, if job security was not addressed in these negotiations, the EI process would have collapsed. With the support of CEO David Kearns (who visited the bargaining table to convey his personal support for the EI process) an employment guarantee was included in the agreement, in return for both some work rule changes and a commitment to grow the EI process.

### *1983-1994: Moving Beyond QWL to Team-Based Work Systems*

Over the decade spanning 1983 to 1994, Xerox witnessed the following events:

- (1) experimentation with various types of team-based work systems—for example, some self-directed work groups and use of ad-hoc teams to solve particular problems.;
- (2) a broad-based training of the management and production workforce in Leadership

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(Cambridge, MA: MIT Sloan School of Management, 1997). See also Cutcher-Gershenfeld (1988).

through Quality (LTQ) techniques and tools; (3) the gradual recapturing of Xerox's market share; (4) the winning of the Baldrige Award for the company's quality programs; (5) the re-negotiation of two collective bargaining agreements that reinforced commitment to the labor-management partnership and continued the employment security guarantees; and (6) leadership transitions—Xerox's CEO, the company's director of industrial relations, and the local union's key leaders all changed at least once. The partnership endured these changes and, in fact, became well-known as a national model of union-management relations.

#### *1994: Negotiations*

In 1994, the company and union agreed to renegotiate their labor agreement in mid-term, in response to a series of crises that threatened continuation of the partnership and indeed the bargaining relationship itself. Xerox was continuing to rationalize its manufacturing operations, bargaining unit employment was declining through attrition due to the continued guarantee of employment security for incumbent workers, the layoff of 10,000 white-collar workers was announced, and rumors of possibly moving manufacturing operations to North Carolina and/or Mexico were being spread. These negotiations were perhaps more intense for their intra-organizational bargaining than for the negotiations across the table. Inside the company, the director of industrial relations had to confront the proposed relocation of manufacturing operations; within the union, the threat to job security and company demands to lower entry-level wage rates, allow greater use of temporary workers, and make additional changes in work rules were controversial. In the end, CEO Paul Allaire accepted his industrial relations director's recommendation to commit to a long-term (seven-year) agreement that continued the employment security guarantee for incumbent workers and therefore the commitment to maintain manufacturing operations in Rochester in return for the new, lower wage structure and flexibility in staffing.

#### *1998: Profit Sharing, Stock Purchase Plan, and Bonuses*

In the four years following the 1994 agreement, Xerox's stock price, profits, and

global businesses performed extremely well. In recognition of these improvements and the lack of wage increases, Xerox offered and union leadership and rank and file workers accepted a new profit-sharing and stock-incentive purchase plan, along with a one-time 3 percent wage increase.

## **Future Challenges**

Despite the long-term success of the partnership, its future is uncertain. In 2001, the contract containing the employment security provisions expires. Pressures on Xerox to balance employment opportunities on a global basis in order to penetrate markets are intense. Outsourcing opportunities for lower-skilled manufacturing work are available to Xerox, as they are to other large manufacturing companies (see the Lucent case). Leadership transitions are occurring within the company—a new CEO will be in place by 2001, and the director of industrial relations (IR) who carried the partnership through its difficult days in the early 1990s and in the 1994 negotiations has left the company. In fact, a succession of several IR directors has moved in and out of this position since his departure. How these forces play out in the future of the partnership is therefore quite uncertain.

Xerox and UNITE have sustained a successful partnership for two decades, and more importantly through the transitions of two CEOs, two union leaders, and a number of changes in the leadership of the company's industrial relations function. Another CEO transition is looming, and the parties face significant challenges ahead as the current labor agreement expires soon, when some within Xerox already favor outsourcing more of its manufacturing work to lower-cost alternatives and the business is shifting to digital-based technologies and products. Yet, the resolve to continue the partnership and address these issues remains strong among leadership at the company and the union. A veteran manager—who, based on his long tenure in that position at Xerox, has the trust and respect of the union—has been put in charge of industrial relations. The heir apparent to CEO Paul Allaire has already begun meeting with union leaders and assures them of his intention to carry on the partnership's principles. Thus, while the issues facing the parties will be difficult, they are taking steps now to carry the partnership forward into its next phase.

## Summary and Implications

The Xerox-UNITE partnership represents the most enduring example of the strengths and potential of sustained innovation and adaptation in American labor-management relations. It also demonstrates such a partnership's vulnerability to the pressures that companies and workers now face due to changing technologies and market uncertainties. Finally, it provides a glimpse of what it takes to respond to these challenges. These strengths, vulnerabilities, and responses of the partnership are summarized below.

The strengths and achievements of the Xerox partnership are the following:

1. It is grounded in a proven, shop-floor employee involvement and teamwork process that has demonstrated its ability to improve quality and productivity. As far back as the mid-1980s, as Xerox struggled to transform its organization to focus on quality, the bottom-up change process, combined with the top-down Leadership through Quality initiative, convinced company executives of the programs' value to the company. Both quantitative and case study research validated the contributions of these processes as well.<sup>5</sup>
2. It tackled the tough issues of job security in ways that were viable for the firm and responsive to the deeply felt concerns of employees. These issues were first joined in the 1983 negotiations and then extended and modified in each successive round of bargaining through the 1994-2001 agreement.
3. It integrated the collective bargaining process into the change effort—using bargaining to join tough issues but also conducting negotiations in a fashion that reinforced the values and substantive objectives of the shop-floor participation and the organizational transformation process. This effort also began during the 1983 negotiations and carried forward to the 1994 seven-year agreement.
4. The parties adjusted the terms of their agreement to accommodate the gradual broadening of the employee participation process and changing competitive conditions and firm performance—again starting as far back as 1982 with the wiring harness experiment and continuing through the decision in 1998 to pay employees a lump-sum increase, as well as introduce a new stock option and enhanced profit sharing plan.
5. The process has been supported and reinforced with strong commitment by

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<sup>5</sup> See the case study by Cutcher-Gershenfeld (1988) cited above and his quantitative evaluation of the workplace innovations in Cutcher-Gershenfeld (1991).

leadership—both of CEOs and union officials. Most important, high-level of commitment has been passed down through three successive CEOs (Peter McCullough, David Kearns, and Paul Allaire), three sets of union leaders at the local level (Les Calder, Tony Costanza, and Gary Bonadonna), and three at the national level (Jack Sheinkman, Arthur Loewy, and Bruce Raynor).

6. This top-level commitment is maintained by biannually scheduled “summit” meetings to share information on developments in the company, in the union, and in their relationship. These meetings serve to both build and reinforce trust. As one of the union leaders who participates in these sessions put it: “We are on the same page; we can count on them to do what they say.”
7. Of equal importance, strong professional leadership in Xerox’s IR department perpetuated the commitment—again, dating back to the beginning of the effort, when Director of Industrial Relations Bill Asher held “Friday-afternoon seminars” with David Kearns to acculturate former IBM CEO Kearns in the labor-management culture of Xerox. Joe Laymon continued this leadership and commitment in the late 1980s through the mid-1990s. The direct access these directors have had to the CEO has been critical to winning various internal management conflicts over competing priorities such as the wiring harness outsourcing issue in 1982 and the proposal to move manufacturing operations to North Carolina in 1994. The 1999 decision to promote a veteran industrial relations professional, who has worked with the union for over 20 years, to the position of corporate director of industrial relations represents a strong signal of the company’s intention to continue the partnership.
8. The partnership was responsive to the economic and strategic needs of the company to improve quality and reduce manufacturing costs by improving productivity and flexibility in its operations. The ability to move non-productive work out of the operation and bring new work in has been critical. As a result, employment and bargaining unit membership has remained relatively constant. In 1980, it was approximately 4,000 and, in 1998, it was approximately 3,800.

There are several challenges that must be addressed if the partnership is to continue. Listed below are a number of vulnerable areas with which labor and management must contend:

1. **The manufacturing challenges facing Xerox are much greater today.** Changing technologies—the movement to digital-based machines—requires different skills of the workforce and less labor to produce. Therefore, the skill mix of the workforce must adapt. This is a significant challenge, but not the company’s primary one, however. That challenge lies in the pressures to outsource more of its manufacturing operations to lower-cost

vendors and/or to relocate more of its production in lower-cost countries. Whether or not the pace of productivity improvement, quality, and flexibility is enough to overcome the gaps that were closed in the 1980s through the EI and LTQ process is an open question.

2. **The manufacturing workforce is likely to shrink in size, regardless of whether work is outsourced or performed within Xerox.** The fact that job growth at Xerox lies outside of the bargaining unit has been, through joint agreement, kept off the table and off limits for the union. How the service technicians and sales representatives and the supervisory and middle managers at Xerox will fare as the same pressures of technological change and uncertainty in the marketplace play out is a predominant question for the company and its employees. And, the lines dividing these groups and those in the bargaining unit are becoming increasingly blurred. Yet these groups have no voice in the partnership and they were not protected by the employment security agreements negotiated for bargaining unit employees.
3. **The employment security agreement expires in 2001.** Given the points raised above, and the continued interest of the workforce and the union in employment security, this major issue will only be resolved if the parties begin exploring options well in advance of the contract deadline. Job security solutions in the past were agreed to *after* the other key strategic and directional issues were resolved—at that stage, the company and the union could make commitments that were enforceable based on the other elements they had agreed to do and achieve.
4. **Company and union leaders understand these challenges and state their determination to both address them and continue the partnership into the next century.** Heir-apparent CEO Richard Thoman is meeting with union leaders both in the semi-annual “summit” sessions and in other settings, including a visit to the union’s headquarters where in the presence of both union leaders and his top management staff, he has expressed support for and interest in continuing the partnership. After several false starts at replacing the corporate director of industrial relations, who had been instrumental in nurturing the partnership through some difficult times in the early 1990s, a veteran professional who supports the partnership’s principles was promoted to fill this position. The company’s top human resource position was also filled recently by another individual who had worked effectively with union leaders in her prior position. Top executives have continued to demonstrate their commitment to the partnership by overruling and reversing outsourcing decisions made unilaterally by business unit executives that were found to be inconsistent with overall company policy. The option of opening talks over the next contract well before the 2001 deadline is being considered.
5. **Finally, despite pressures to outsource from within the company, Xerox’s**

**top leaders may prevail.** The fact that some managers within the company are opposed to continuing the partnership and favor moving or outsourcing production to take advantage of lower-cost alternatives is openly acknowledged by top executives. They view these opinions as a natural feature of the different responsibilities and priorities leaders in different functions and at different levels of responsibility have in a complex organization. But, in the end, top company executives take responsibility for setting the principles that will guide labor-management relations and resolving these different points of view.

More than anything else, this case demonstrates the importance of strong support from top leaders and careful leadership succession processes for sustaining labor-management partnerships over time. But, it also demonstrates that this view will not be shared uniformly throughout management's ranks and that the conflicting views need to be acknowledged and dealt with directly.

## Saturn

The Saturn Corporation is a wholly-owned subsidiary of General Motors that manufactures and sells small cars. From its initial planning process, conducted in 1983 by a "Committee of 99" consisting of GM and UAW representatives, Saturn was conceived of as a full partnership between the union and the company. The decision to create Saturn was motivated by company and union desire to build and sell a small model in the United States that would compete well against imports and to create jobs for UAW members. The decision to create an entirely new company at a greenfield site was made after management concluded that GM could not competitively manufacture a small car in the U.S. under the existing labor contract and management policies.

### Key Events

Several key events have shaped the GM-UAW labor-management experiment taking place at Saturn: equal partnership between union and management in the design of the organization; the emergence of co-management; the importance of performance *and* image; the introduction of conflicts and controversies about Saturn's future within the union and GM after its original champions retired; and concerns over Saturn's long-term viability as expressed during 1998 contract negotiations.

### *Joint Approach to Organizational Design: The Committee of 99*

The Committee of 99 developed an organizational design that makes the UAW an institutional "partner," participating in consensus-based decision-making from the shop floor to the levels of senior management. This structure is overseen by a series of "decision rings" at the department, plant or business unit, manufacturing policy, and strategic policy levels of the organization. Through the partnership's arrangements, the UAW becomes an important part of strategic decisions made regarding supplier and retailer selection, choice of technology, and product development. An initial 28-page collective bargaining agreement outlines the basic principles governing the relationship

and the team-based system of work organization.

The partnership process is complemented by employment practices designed to ensure that employees have the knowledge, skills, and motivation to contribute to the performance of the enterprise. Saturn requires all employees to take a minimum of 92 hours of training each year. In 1995, 20 percent of compensation at Saturn was contingent on the completion of this minimal amount. In addition, more than 80 percent of the workforce is guaranteed employment security for life. Work organization at Saturn is based on self-directed work teams of 10 to 15 members, who are cross-trained and rotate responsibility across the tasks in their unit. Teams have collective responsibility for hiring new members and electing their own team leaders. The next level of organization, called modules, cover an average of five to seven teams and conduct weekly governance meetings in which teams are represented by their leaders. Teams also have responsibility for quality assurance, job assignments, record keeping, safety and health, material and inventory control, training, supplies, and housekeeping.

### *Emergence of Co-Management*

As the organization took shape, local union officials and management added another unique feature. At the department or module level, management responsibilities became shared by two "module advisors," who are partnered. Each "partnership" at the department level consists of union module advisors who are partnered with non-represented management module advisors. This feature of the partnership makes Saturn the boldest experiment in co-management found in the U.S. today.

Until 1994, jointly-selected UAW crew coordinators maintained responsibility, along with their non-represented partners, for managing crews across several departments, which is the responsibility of superintendents in GM's more traditional plants. However, in 1994—as a result of a negotiated agreement and in response to considerable pressure from rank and file workers—the 14 UAW crew coordinators became elected officials with the authority to file grievances.

## *Performance and Image*

Saturn uses as its marketing slogan and logo the following phrase: "A Different Kind of Company. A Different Kind of Car." Thus, it builds on its partnership with the UAW and several other distinctive features of the company's practices—such as its fixed price, no-haggle, retail sales and service strategy—in positioning the company and its products in the minds of consumers. To date, this approach has been very well-received by the market. According to the J.D. Power Customer Satisfaction Index, within two years of its first production run in 1990 and in every year since, Saturn achieved higher ratings in initial vehicle quality, in satisfaction after one year of ownership, and in service than any car in its class. Only Lexus and Infiniti, two upscale models costing three times as much as Saturn, received higher customer satisfaction ratings.

Saturn's productivity and profitability, however, are not as high as its quality ratings. Yet, its productivity levels still remain near the top of those at GM's other plants. In evaluating profitability, a question arises: Should Saturn amortize this investment alone, or should the rest of GM's enterprise—which was supposed to learn from this experiment—share in their costs? Regardless, Saturn generated its first operating profit in 1993 after mobilizing its third crew and being pressured by its GM parent to cut costs and move up the date targeted for achieving a profit. Bonuses based on financial, productivity, and quality goals have been paid to Saturn employees each year since 1993. The 1995 and 1996 bonuses totaled \$10,000 for each member, which is the maximum allowable under the contract. Bonuses declined in 1997 and 1998, as Saturn's sales declined.

## *Conflicts and Controversies*

Despite its successes, Saturn is a controversial topic within both the UAW International Union and GM. Several years after Saturn was created, its original champions within both the UAW and GM retired. Their successors were not as committed to Saturn's principles and partnership structure. Meanwhile, over the course of the 1990s, GM and the UAW experienced an intermittent set of strikes, largely over

questions about outsourcing. These conflicts peaked during a seven-week strike in the summer of 1998, which shut down nearly all of GM's production operations. At the end of this strike, both GM and UAW leaders pledged to find a better way of dealing with these issues—yet what, exactly, this promise means remains uncertain. GM continues to feel intense pressure to outsource more of its component production to outside vendors. In fact, it announced shortly after the end of the strike its intention to group component operations into a separate division (Delphi), as well as to continue exploring options for divesting component operations that are not competitive with outside alternatives.

UAW leadership and the leaders of the Saturn local have been experiencing considerable internal conflict over the past decade on a host of issues ranging from the adequacy of representation on traditional issues to shift schedules, overtime and shift premiums, and other administrative matters. Political factions have also arisen within the local (similar to the dynamics at other UAW local unions). For example, each election of union officers since 1992 has been hotly contested.

GM management has also been ambivalent about Saturn. On the one hand, the corporation relishes the positive image that Saturn has achieved and urges other divisions to learn from Saturn's experiences. On the other hand, while some technical and marketing innovations have been adopted, there is little evidence that significant learning from or diffusion of Saturn's organizational principles has occurred within GM. Moreover, in 1996 GM decided to accede to the International UAW's preference to build the second generation Saturn model in GM's Wilmington, Delaware plant—not in Spring Hill, as requested by the local union and management. The labor agreement negotiated at Wilmington calls for some use of teams and employee involvement, but does not include the full partnership model found in Spring Hill; it remains a part of the national UAW-GM contract.

In 1998, GM announced that Saturn's engineering, design, and parts sourcing decisions would be integrated into the GM small car division as part of its overall re-centralization of these functions.

Finally, Saturn has somewhat of a schizophrenic identity. On the one hand, it receives many accolades for innovative organizational design and employee relations,

as well as for favorable customer satisfaction performance. On the other hand, many of the provisions of the partnership are of questionable legality under American labor and employment laws; the co-management and shared governance structures have been criticized by some business leaders as rescinding important managerial prerogatives; and some union leaders are critical of the many long-standing work rules that the union abandoned in return for this type role in the governance and management process.

### *1998 Negotiations*

Concerns over these developments came to a head in Spring Hill in 1998. In April of that year, the union—in response to rank and file concerns over the long-term viability of Saturn—held a referendum over whether to continue the partnership as specified under the local agreement or to return to the national contract. Sixty-eight percent of the membership voted in favor of continuing the partnership as specified in the Saturn agreement. Then, in the summer of 1998, the union took a strike authorization vote and issued a 30-day strike letter in an effort to resolve an ongoing dispute over both the formula for the risk-reward plan and the broader issue of the future product stream planned for Spring Hill. These negotiations produced an agreement that included the following provisions: GM would build a Saturn Sport Utility Vehicle at Spring Hill; the union would be included in the sourcing decisions affecting Saturn products; moreover, four factors (cost, quality, brand image, and job security) would be considered in making sourcing decisions; and a compromise resolution to the parties' different interpretations of the risk-reward formula would be enacted.

These negotiations served to force a decision on Saturn's future, which had been either delayed or allowed to drift for several years. GM was forced to decide how Saturn would fit into its larger centralization effort, as well as its common engineering, purchasing, and platform strategies and structural realignment. It also had to choose which—if any—future products would be produced at Spring Hill. The result was that GM stated its continuing commitment to the Saturn Partnership and reinforced this commitment by agreeing to build the Sport Utility Vehicle in Spring Hill, as well as to

give the union a voice in sourcing decisions. Yet, despite these major compromises and commitments, GM continues to follow its recentralization and outsourcing strategies. GM's strategy remains rather ambivalent—trying to accommodate the principles of the Saturn partnership while simultaneously integrating Saturn into the corporation.

The negotiations involved considerable use of traditional bargaining tactics by the union, including severe criticism of the commitment and competence of Saturn's senior management. A strike vote was held, the pace of production slowed, union leaders went around Saturn management to pressure GM executives, and the union used the leverage created by bad publicity. These strategies, in turn, irritated Saturn management officials and fostered bad feelings.

## **Summary and Implications**

In a recent paper, Saul Rubinstein and I (Kochan and Rubinstein 1998) argue that Saturn represents not only the most comprehensive labor-management partnership model found in the U.S. but also an organization that embodies many of the principles of what is meant by a “stakeholder” corporation:

1. Saturn was designed to achieve both GM's shareholders' goal of making a small car profitably and the workforce and union's goal of building small cars in the U.S. with U.S. workers and UAW members; this fact implies that the success of the firm should be measured against these multiple objectives.
2. Workers and union representatives were to be full and legitimate partners in the governance and management processes of the firm, and
3. Workers share the risks and rewards of the firm's performance with shareholders.

Thus, more than any other U.S. case, Saturn illustrates a type of organizational partnership and employment system that can be created when a union with a vision of its own participates in the design, governance, and management of the enterprise. Workers have a strong voice on both traditional labor-management and broader managerial or strategic issues. Principles of teamwork, continuous improvement, quality, safety, ergonomics, and customer satisfaction are given high priorities.

Conflicts occur both within and across traditional labor and management boundaries, but are managed and resolved differently than through the reliance on traditional contract negotiations or grievance arbitration processes.

Whether Saturn's limited profitability to date implies that this organizational model inevitably redistributes some of the financial rewards across the different stakeholders at the expense of shareholders is still an open question—one that is likely to be the subject of considerable debate in the future. Thus, despite the positive publicity that the UAW-Saturn partnership has received and its success on the quality and marketing fronts, the ambivalent support from both parents (UAW International and GM), leave the future of Saturn somewhat uncertain.

At the same time, GM and the UAW both realize that the traditional approaches they have taken to their relationship in general have not addressed the underlying competitiveness and job security challenges they face. Both parties are examining future options. Whether any of the principles, practices, and lessons from a decade of Saturn experience will be brought to bear on this larger relationship remains to be seen.

Over the past several years—and particularly over the past year—the parties have been caught in a downward, reinforcing spiral. The union was frustrated with a lack of leadership and decision-making power within Saturn management and the lack of support from UAW national leaders. Its renewed militancy has left some managers feeling they have been betrayed. At the workplace, the partnership was put on hold. Workers, in turn, became demoralized, as they saw sales and production fall; as the relationship deteriorated, they began falling into traditional patterns. Therefore, performance declined, adding further to costs and the frustration of management.

GM agreed to a settlement that is inconsistent with its larger strategy of centralizing design, purchasing, and outsourcing components. It gave the union a role in purchasing/sourcing decisions, using the criteria of cost, quality, brand equity (image), and job security. They did so in this instance because the UAW threatened a strike that would have imposed big economic and public relations costs on the company—and might have signaled the death of the partnership principles. How the new arrangement will be implemented and made to work in the context of GM's broader centralization and outsourcing decisions remains to be seen.

Saturn represents the most far-reaching example of a labor management partnership model, one that embodies more of the features of a stakeholder model of the corporation than any other example discussed here. As such, it suggests both some strengths and limitations.

On the one hand, it shows that multiple objectives of firms and employees can be achieved and balanced if both labor and employer representatives share a commitment to building and sustaining a partnership—that is, a legacy of mutual commitment fostered by the first generation of leaders who built Saturn. Second, it demonstrates that this type of employment relationship and the commitment to quality and customer service resonates positively with consumers and has a positive market value.

But the case also illustrates the significant resistance that exists to sharing power fully and redefining the basic mission, goals, and governance structures of the American corporation—and, therefore, the difficulty Saturn has experienced in sustaining support from leaders both within its parent labor and corporate organizations. It also suggests that significant changes in labor and employment laws, as well as perhaps in corporate law, would be needed to allow this full type of stakeholder firm to emerge and survive in the United States.

A further limitation of the Saturn model is the fact that—like the other examples discussed here—“non-represented” managers and professionals were not formally included in the governance process. How to treat these employees remains an open question.

## United Airlines

United Airlines is the largest majority employee-owned enterprise in the United States. In July of 1994, employees represented by the Air Line Pilots Association (ALPA), the International Association of Machinists (IAM), and non-union employees at United purchased 55 percent of the company. United's flight attendants decided not to participate in the buy-out.

The terms of the ESOP included the following:

- Pilots and machinists accepted pay cuts ranging from approximately 12 percent to 15 percent, and non-union employees took 8.25 percent cuts in pay. The pay cuts last six years; they are scheduled to expire in 2000.
- Employees are guaranteed employment security for six years.
- Pilots accepted a two-tier wage plan, allowing lower wages for pilots who fly the United Shuttle.
- A "market hiring rate" (essentially, 50 percent below prior current hiring rates) was to be used in hiring future non-union, non-management staff.
- New recruits were to contribute 25 percent to their medical plan.
- ALPA, the IAM, and non-union employees each gained the right to appoint one member to the 12-member board of directors and to jointly select (with the CEO) four outside, independent directors. These governance provisions last as long as the employees own at least 20 percent of the company's stock. Given this provision, this governance structure should stay in place until approximately 2019.

The United case illustrates the potential of an ESOP for providing employees with a voice in key governance structures and processes, as well as in the strategic direction and decisions of a firm. However, as the analysis below suggests, it also illustrates that a voice in the governance process is not sufficient. Unless that voice is matched by changes in the workplace culture and practices and in labor-management relations and processes, the potential of the ESOP to add value to the firm and to meet employee expectations and interests is unlikely to be realized.

Four years after the creation of the ESOP, its record is mixed at best. On the one

hand, company profits have increased and the value of the stock has increased. But these improvements mirror those of other airline companies. Labor relations have not changed significantly, and there is little evidence that employees enjoy greater involvement and voice in the day-to-day issues that affect them or that influence operational indicators such as on-time performance, customer satisfaction, or productivity. Cultural change efforts, it might be argued, have been largely symbolic and incremental rather than systemic. In the case of supervisors, their reductions in numbers and changed role may have had negative results. On the other hand, employment security has been maintained, and union representatives have influenced a number of critical decisions, including the selection of the CEO. The long-term future of the ESOP rests on how the parties address several critical challenges facing them in the next two years, including choosing a new CEO, renegotiating their collective bargaining agreements, and deciding whether to extend ESOP provisions into a second generation.

## **Key Events**

Several events in the history of United's employee-ownership arrangement highlight its strengths and weaknesses: the 1985 pilot negotiations; the ESOP deal itself in 1994; the 1997 wage reopener; the passenger service agent organizing campaign; the regional jet negotiations; the flight attendants' negotiations in 1997; the issue of rest time for pilots flying 777s on Pacific routes; past and future leadership succession; and the renegotiation of bargaining agreements and the ESOP.

### *1985 Pilot Negotiations*

A 1985 strike by United's pilots set the stage for the series of events leading up to the 1994 ESOP. The lesson management drew from the strike about the power of the pilots continues to influence thinking within the firm today. The effects linger in residual distrust between the union and management, as well as between political factions within the union. The issue at hand during the 1985 strike was largely the

company's demand that pilots accept a long-term, two-tier wage agreement that would allow United to compete on short-haul flights, especially on the West Coast. The union rejected this proposal and, while it agreed to a modified two-tier provision, the pilot's success in shutting down the airline and forcing a compromise signaled their considerable bargaining power to management.

Shortly after the 1985 strike, CEO Richard Ferris initiated United's short-lived effort to diversify the company and make it a "full-service" travel business. He bought Hilton Hotels and Hertz Rent-a-Car. This diversification effort was strongly opposed by the pilots and led to their first bid to buy the company. While the bid failed, it sparked a shareholder revolt against Ferris and his diversification strategy—leading to his resignation and the sale of both Hilton and Hertz in favor of refocusing on the airline business.

Between 1987 and 1993, the pilots made three additional efforts to engineer an employee buyout of the airline. Only the fourth effort was successful. Unlike the first three buyout efforts, the IAM joined the pilots in the buyout proposal.

### *The ESOP Deal*

As the terms summarized above indicate, the ESOP negotiations focused on the financial aspects of the deal. According to one management official, this narrow focus is a major cause of many problems the parties have encountered later—in plain terms, the deal failed to address the people and relationship issues up front:

"Deal makers (investment bankers) drove the process and collective bargaining issues and relationship issues were not given adequate consideration. They didn't think of any of these. The focus was on the "deal"—the financial aspects of getting it done. No consideration of how the four parties (management, IAM, ALPA, and non-union employees) would have to deal with each other. Indeed, some promises were made about collective bargaining relationships that created expectations that were not met because the people who made them were no longer around to deliver on them.

This created two problems: The parties started their ESOP without clear expectations for what kind of relationship would be needed to make it work, and (2) the parties started with the mistaken expectation that behaviors would change on both sides just because of the ESOP."

Moreover, the motivations of the many groups involved in the ESOP were different. ALPA was the moving party and was interested in gaining a voice in the governance process and some control over the strategic direction and decisions of the firm. The IAM, on the other hand, was primarily interested in gaining job security. The non-union employees had no representation in the ESOP negotiations. Some of these employee expressed frustration over having the ESOP forced on them.

In the first year of the agreement, new CEO Gerald Greenwald was hired with the unions' support. Greenwald stated he was committed to spending up to 50 percent of his inaugural year with employees and made strong statements about the importance of empowering employees and gaining their input. However, expectations for what the ESOP meant for managers or how employees might act as owners were not clarified or communicated in a clear way. Things appeared to be going well, however, as financial and on-time performance improved.

A number of separate efforts were initiated in the first few years of the ESOP to change United's workplace culture. These efforts included culture change workshops (Culture Leadership Training, or CLT) and a range of other communications programs (for example, one was known as Mission United). But, according to both an internal management assessment and a case study of United performed by an outside consulting firm, these efforts were neither systematic nor reinforced in day-to-day operations. They therefore achieved little or no change. Given the heightened expectations associated with the ESOP, the lack of follow-through may have increased employee skepticism and/or disappointment. One case study stated the effects in the following way:

It is true that a number of important steps were taken in the two years following the deal to promote a culture more oriented towards productivity improvement. But the evidence is that, for one reason or another, those efforts were not sufficient to change attitudes very much (Oakeshott 1997).

### *The 1997 Wage Reopener*

The 1997 wage reopener demonstrated that the low level of trust that existed between the unions and management had continued. These negotiations also left the impression that labor relations had not changed. By the time that the wage reopener began in late 1996, the ESOP had been in effect for two years. Profits had risen and resulted, based on a formula contained in the ESOP, in substantial bonuses for the top 600 executives in the firm. The ESOP agreement provided that arbitration would be used to determine the wage adjustment if the parties could not agree. The maximum amount the arbitrator could award, 5 percent per year, was also detailed in the ESOP agreement. The ALPA spokesman, however, stated that going into arbitration would signal a failure of the ESOP.

In December, a tentative agreement was reached at the bargaining table that called for a 3 percent increase for two years followed by 2 percent increase in the final two years of the agreement. The pilot's negotiating committee took this proposal to its Master Executive Council and eventually held a rank-and-file vote. The rank and file rejected the proposed agreement by a 4-to-1 margin. After the vote, the ALPA leader at United (who also served as its representative on the board) announced that the union and its members would no longer cooperate with management on any of the joint initiatives they had begun.

In the end, the parties returned to the bargaining table and reached an agreement. The settlement provided for 5 percent increases in the first two years of the contract and, perhaps more importantly, for employees' original wage levels—reduced as part of the ESOP plan—to be restored when the ESOP agreement expired in 2000. (This type of provision is often referred to as a “snapback” provision—wages snap back to their prior level.)

### *Passenger Service Agent Organizing Campaign*

Another source of tension in the labor-management relationship emerged in 1997, when the IAM informed the company that it had signed authorization cards for a majority of the non-union passenger service agents and asked the company to recognize

the union. The company felt it was in a dilemma, again caused by the failure of the parties to anticipate how to deal with such issues when they signed the ESOP agreement.

On the one hand, the company felt it would be inappropriate to actively campaign for the defeat of a union organizing drive. On the other hand, since these employees were not able to vote on the original ESOP plan, it seemed important to give them an opportunity to vote on this issue, rather than have the company decide on union representation for them. Moreover, within management, some executives wanted to present a factual statement about the question of these workers organizing. After failed attempts to negotiate an expedited process outside the election rules required by the National Mediation Board, an uncontested election was conducted. Management did hold information meetings, but with a few exceptions otherwise remained neutral. The majority voted for union representation, and the IAM was certified to represent these employees. In the end, the company's decision to require a vote created tensions within both the union and the board of directors.

### *Regional Jet Negotiations*

After the ESOP plan was implemented, the company and ALPA returned to the difficult issue of how to structure an agreement to allow greater use of regional jets. The need to do so was intensified by the flexibility enjoyed by United's competitor, American Airlines. American maintains a separate company—American Eagle—to fly its regional routes. It had reached an agreement with its pilots in 1996 that gave it considerable flexibility in the use of this lower-cost alternative to feed its long-haul domestic and international flights. United's management and ALPA initially tried to address this issue in a problem-solving fashion that ultimately failed. In the end, they negotiated a very traditional agreement—14 pages of detailed rules governing the use of regional jets and the number of routes the regional carrier could fly.

### *Flight Attendants' Negotiations*

In 1997, another significant negotiation occurred that once again demonstrated the mixture of traditional and innovative labor relations at United. The Flight Attendants Association (AFA) and the company negotiated a long-term (10-year) contract that involved considerable use of “interest based”—problem solving, joint analysis, and information sharing—techniques. The tentative agreement reached contained a “wage spike” that would increase wages above what appeared to be a competitive level at mid-term and then slowly bring the wage level back to around to what would likely be the industry standard by the end of the contract. The net result of this negotiation was to further chill relations with union leaders.

### *777 Rest Issue*

In 1998, another issue arose that, when this paper was being written, was still being negotiated. It involved the company’s plan to use 777 aircraft to fly its Pacific routes and the question of whether a bunk would be installed in these planes to provide rest time for pilots. Management indicated that Pacific routes were becoming more competitive, and the current 747s used to fly them needed to be replaced by more cost-effective 777s.

Again, an effort was made to introduce a more problem-solving approach to negotiations, but one that recognized the need to carry over certain traditional negotiating principles as well. Specifically, the company proposed a four-step process to guide these negotiations: (1) define the issue; (2) cost it in a reliable fashion and share the data; (3) define the implications of not reaching an agreement; and (4) set a strict deadline for getting an answer. This approach was designed in part to apply greater discipline in management’s own approach to negotiations. (Many believed that, in the past, management felt the only power it had during negotiations was control over data and information—and so information was held closely.) The negotiations were also allowed to drag out without conclusive results. Management negotiators wanted the company to decide what it would do if an agreement couldn’t be reached on this issue. When pressed, the answer was that, if no agreement was reached, United would stop flying its Pacific routes.

It took several months to generate the reliable cost data the parties needed to document the problem and negotiate the issue. Eventually, the company proposed that, while it could not outfit the 777s immediately with bunks, it would commit to do so by 2001; in the meantime, other rest accommodations were made for the pilots. The pilots responded with a counterproposal, and the company was drafting a response when this report was written.

This example illustrates how a blending of traditional and interest-based approaches to negotiations are being used at United. Within both the management and union organizations there is considerable opposition to and skepticism over moving too far in the direction of problem-solving approaches. Concern over a political backlash from the rank and file or potential rivals to current officers makes union leaders reluctant to appear to have a cooperative or cozy relationship with the company. The same views prevail among some company executives. These attitudes have been conditioned by the industry's longstanding tendency to wait until the amendable date to begin negotiations and to then take two years or more to negotiate an agreement. In an attempt to take a problem-solving approach, an early beginning was proposed for negotiations over the contracts that are amendable in 2000. However, there is considerable skepticism about this approach, particularly among IAM leaders. Thus, a mixed approach to negotiations is more likely to be followed to deal with the complex issues involved.

### *Leadership Succession*

In September of 1998, United announced that COO [**Tom: ??**] resigned from United after the board indicated he had lost the support of the unions and would not succeed Greenwald as CEO. Greenwald's term is up in 1999, and a search is now underway for his successor. Moreover, within the next two years there is likely to be a leadership transition within ALPA as well, since the union's rules allow only two consecutive terms for its leaders.

### *Renegotiation of Bargaining Agreements and the ESOP*

The ESOP agreement expires in 2000, when the collective bargaining contracts reach their amendable date. As noted earlier, however, the governance features of the ESOP continue until 2019. Thus, the parties face critical choices regarding the leadership of the company, the process to use in renegotiating bargaining agreements, and the ultimate question of whether or not to renegotiate the financial terms of the ESOP—essentially, continuing it into the future or allowing it to slowly atrophy. At this point, ALPA appears to remain more interested in extending the ESOP into a second phase, while the IAM is less certain. While the top executives of the company continue to express support for the ESOP, views among other senior managers range from indifference to disinterest to a clear preference for allowing the ESOP to expire.

### **Taking Stock of the ESOP**

What has been the ESOP's effect to date? While I have not attempted to conduct a systematic analysis of this question and more interviews of the different stakeholders involved need to be conducted, I can offer the following tentative observations.

The company has not improved its operating performance on the metrics commonly used in the industry to track quality and customer satisfaction. The most recent data published by the Department of Transportation (January through June, 1998) show that, out of the ten major U.S. airline companies, United ranks fifth in passengers declined boarding (i.e., those who are bumped due to over-booking), ninth in on-time performance, tenth in baggage mishandled, and sixth in consumer complaints.

While it has improved its profitability since 1994, so have its competitors in the industry. One effort to decompose the sources of increased profitability concluded that 90 percent of the increased profits are attributable to the following: (1) the labor cost reductions provided in the ESOP; (2) the tax benefits of the ESOP; (3) the increased demand for air travel experienced in the industry; and (4) savings and market growth associated with the regional jet/United Shuttle arrangements (Oakeshott 1997). The company's stock rose in tandem with the overall rise in the stock market from 1994 to 1997, increasing the value of the shares held by employees or cashed out by employees

who left the company during this time period.

Yet, many executives within the firm believe that the investment community under-values the company's stock and cite the fact that it trades at only about nine times its earnings, compared to a multiple of 15 times earnings for its competitors. One industry expert agrees that the ESOP is not helping the company in the marketplace, especially given the uncertainties it faces with the anticipated departure of the CEO and uncertainty over his successor, the need to renegotiate the labor agreements, and the expiration of the ESOP plan in 2000. Thus, there does seem to be some price that employees and the firm are paying for the control employees exercise within the firm.

When asked if the ESOP has had a significant effect on the labor-management relationship within the company, one management official assessed it as essentially neutral—it has had neither a major positive nor a negative effect. The pilots and the company were, however, able to address competitiveness issues during the life of the contract, rather than stockpiling these issue until the scheduled renewal date.

## **Future Scenarios**

Given this uncertainty, it is difficult to predict the future of the ESOP at United. One possible scenario is that the parties will allow the ESOP to expire in 2000, while the governance features continue well into the next century. How the investment community and the employees respond if this occurs is a topic open to debate.

A second scenario is that history will repeat itself—that is, the interest ALPA has in continuing the ESOP plan will lead it to propose a second-generation buy-out plan that maintains or perhaps even increases majority ownership by employees. To make this option successful, however, ALPA will again require the cooperation and support of other employee groups, particularly the employees represented by the IAM. What price the employees would need to pay to continue to be majority-owners is again an open question. Some within the ranks of management believe the price could be considerably higher than a one-for-one trade of wages for stock, especially since there is no clear evidence that the ESOP has enhanced performance and may lower the market value of the firm.

Other scenarios might identify ways to use the upcoming negotiations to better align the interests and outcomes of concern to the various stakeholders. Such an effort might involve, for example, some type of contingent performance and compensation arrangement whereby stock is exchanged if and when the company achieves specific performance targets. To negotiate this type of outcome would, however, require significant culture change and improvement in workplace relations and operations, and a more interest-based approach to negotiations.

## **United's Competitor: Southwest Airlines**

**S**outhwest Airlines was formed in 1971 to serve inter-city routes in three Texas cities. By 1998, it had grown to approximately 24,000 employees serving 25 states with approximately 2,500 flights per day. Southwest operates as a low-cost, no-frills but high customer service airline flying point-to-point, rather than establishing a hub-and-spoke system common to its larger competitors. A key to its success is the achievement of low turnaround time—the time required for a plane to land and take off again—which requires a high level of teamwork, coordination, and flexibility among different employees and occupational groups. To accomplish this advantage, the company works hard at maintaining a culture that emphasizes flexibility, family orientation, and fun. It has been highly successful, generating profits each year since it was founded and realizing significant appreciation in the value of its stock of over the life of the company. Southwest's quality and productivity serve as benchmarks for the industry. It consistently ranks at the top of the various quality measures—including on-time performance, baggage handling, and customer complaints.

### **Employee Relations**

Nearly 90 percent of Southwest's workforce is organized into nine unions. Four—the pilots and three small technician unions—are independent organizations. The flight attendants and ramp workers are represented by the Transportation Workers Unions (TWU), the customer service and the reservation agents are represented by the International Association of Machinists (IAM), and the mechanics and cleaners are represented by the Teamsters (IBT). The company has enjoyed highly cooperative and peaceful labor relations since its founding. Its founders were not opposed to unions and essentially invited them into the organization. However, management has also worked hard to ensure that the unions maintain the same objectives as the company, avoiding highly adversarial relations.

There are no formal union-management structures or processes for consultation

and representation beyond negotiations and grievance procedures. However, management keeps the union representatives informed of new developments. One example is when the company decided to implement a flexible benefit plan; it met with union leaders and indicated the plan would be an add-on to the existing contractual provisions and therefore did not require negotiations. Union leaders also initiate dialogue, as they did when raising questions over how the company was implementing the Family and Medical Leave Act. Several union leaders questioned the procedures, and briefings were held to clarify how the company was complying with the Act. Other issues around which informal consultations have occurred include workers' compensation administration policies.

The primary channel for employee input is the company's open-door policy, in which employees with questions are encouraged to write to Herb Kelleher with their concerns, suggestions, or questions. These letters forwarded on a daily basis to appropriate managers to prepare a response. All letters receive a response—in fact, sometimes middle managers are concerned with being bypassed by these inquiries or complaints. However, this avenue is widely used, because management does follow up on them. “It's part of the culture,” said one manager.

Top managers also visit four or five stations each year to meet with employees. With no pre-arranged agenda, these meetings serve as another opportunity for management to learn about employee concerns and for employees to bring problems to management's attention. These visits also introduce new managers to the airline's cultural norms.

Southwest also maintains a “culture committee,” comprised of 127 members from different parts of the company. Each year, the Executive Vice President meets with groups of employees to elicit issues and problems of greatest concern. From these meetings, priority issues are identified, and small teams are formed to work on them. Examples include: problems of employee burnout among individuals in a job for a long period of time; a “New City” committee that goes to each new city Southwest serves to educate new employees about the values of the company; and the “Back to Basics” team, which sponsored an essay contest to describe what makes Southwest work. The team chose a series of essays that were integrated into a book with an accompanying

video that is now given to every new employee. These committees are all staffed by volunteers working on their own time.

In short, the values of the company and its practices are implemented by developing the culture of empowerment and family values, not through any formal representative forums or structures.

## **Summary and Implications**

Southwest has used its human resources as assets for achieving and sustaining a competitive advantage. Moreover, it has communicated this intention to its internal workforce, to its customers who expect a highly motivated and friendly workforce and high levels of service, and to the external investment community that continues to value the company highly, indicated by its favorable price/earnings ratios. Southwest accomplishes this success largely through the leadership and culture established by Kelleher and the managers he has hired and promoted. It also does so with unions that embrace the company's culture and have not pursued demands for a role in the management or governance process or jointly-run programs at the workplace.

## Cross-Cutting Themes and Lessons

These case studies were discussed at a November 1997 meeting of the Working Group on the Social Contract and the American Corporation of the Task Force for Reconstructing America's Labor Market Institutions. Eight cross-cutting themes emerged from that discussion and are summarized below. It should be noted that not all participants at the meeting necessarily share all of the views expressed below. Instead, this account represents my distillation of the discussion and what I believe we learned from these cases about the strengths and limits of how employment relations are structured and governed in these firms for the task of renegotiating a social contract that addresses the key concerns of shareholders and employees in today's economy.

### **1. Define the terms of the contract clearly.**

It is clear that the implicit social contract being offered by companies today is different than the implied expectations or obligations of the past. Kodak, for example, has been explicit in its statements, indicating that—while in the past it promised employment security—today employees should expect: (1) open information on the state of the business; (2) opportunities to learn new skills, develop, and remain competitive in the labor market; and (3) financial and labor market transition assistance, if downsizing occurs. This contract may be the most an individual company can offer, although some organizations, such as Saturn, continue to commit to a no lay-off policy. Saturn's promise, however, is the rare exception. While the specifics of implied expectations and obligations will vary (probably closer to Kodak's rather than Saturn's terms), the Working Group agreed that, whatever the "terms" are, they need to be clearly defined and communicated for all types of employees. Such a step is essential at companies such as Lucent, Xerox, and United, where different groups of employees have access to different types of contracts and varying motivations for sustaining a given agreement. Thus, the first requirement in reconstructing a viable

social contract at work today is to be open and explicit about what each party can expect from the employment relationship.

Should the terms of the contract itself be implicit or explicit? Is the concept of a social contract only viable when a union represents employees—or can a shared set of expectations or norms that are “enforceable” in some way exist when employees are not formally represented? This question sparked a vigorous discussion and some disagreement. Richard Locke from MIT’s Sloan School of Management noted, “The idea of constructing a contract is to record elements of a deal, because there is no trust that one or both parties will uphold that agreement. If a contract provision is there, things like benefits, voice, and security won’t be taken away.” Or, to continue Locke’s line of thinking, changes will at a minimum involve negotiations rather than unilateral decision-making and action. For example, although Kodak has maintained its paternalistic stance toward employees, the company’s non-unionized workforce has no recourse if the climate should change. In the case of Xerox, the vast majority of employees not included in the bargaining unit may have benefited from the labor-management partnership, but recent downsizing of clerical, middle management, and sales workers indicates how fragile those benefits actually are.

Dennis Rocheleau of General Electric offered a set of “constants” he believes should be incorporated into newly defined social contracts but suggested that few firms can turn these elements into explicit, binding agreements with employees. The first is to ensure that communication channels are clear and open. “The highest levels of honesty need to be upheld in the information being sent from the top down, and there needs to be open channels for input from the bottom of the organization to the top,” said Rocheleau. Second, employers and employees must share the successes—or failures—of an endeavor. Third, the model should include a shared responsibility on the part of employers and employees for expanding the base of employable skills within a job.

For Lynn Williams, formerly of the United Steelworkers, a key component to any new contract is power-sharing. “As people become involved and recognize how they do contribute, they want that contribution to be recognized and acted upon,” said Williams. In a democratic society, shouldn’t workers expect to have a voice in

corporate decision-making? What part of a new social contract should include those elements? How can such an expectation be realized in a non-union setting?

While no consensus emerged over whether or not social contracts need to be explicit and binding, there was broad agreement that the expectations need to be clear and internalized by both employees and employers. Articulating these expectations generates trust. But, if they are broken, trust is difficult to rebuild. The key question is: How can organizations develop, communicate, and sustain these shared expectations and mutual obligations in the absence of formal representation on the part of employees? It is clear that existing institutional arrangements—union representation or employee involvement in non-union settings—are not adequate to this task. The former covers too small a portion of the workforce, and the latter seldom reaches high enough to influence the centers of decision-making power on these strategic issues. Some new institutional process must be invented and made available in settings where formal union representation with collective bargaining is either not desirable or feasible—but neither is no form of employee participation. There is not, however, likely to be consensus between labor and employer representatives over what such institutions or processes should be.

## **2. Change the whole, not just the parts.**

Renegotiating the social contract involves changing a firm's full system of employment practices and relationships, not just altering one piece of its system. A host of organizational practices and norms have been built around a different social contract—cultures, expectations, traditions, and business processes—that will cause the mere overlay of selected pieces of new model to be inefficient, impractical, or undermined. A large and growing body of empirical research on the effects of various human resource and workplace innovations on firm performance confirms this point. Taking erratic steps or rolling out add-ons will not be sufficient to generate the support needed to realize the new model's goals. Several of the cases illustrated this misstep. While Lucent and Xerox are attempting to infuse entrepreneurial spirit into their large organizations with traditional cultures, GM has failed to integrate the innovations of

Saturn into its other divisions. Clearly, without establishing a uniform culture or a consistent business philosophy, the gains realized by limited experiments will be short-lived.

In order to diffuse pilots and experiments across a large organization, mechanisms for changing the culture of the entire enterprise must be embedded in the design right from the start. Nancy Mills of the AFL-CIO noted how difficult this cultural transformation is. She knew of few successful cases in which a pilot project was diffused throughout a large organization, in part because participants in the pilots often self-select—employees interested in new modes of working are recruited, making the participation-performance equation work. Extending new models into other parts of the organization would require a long, committed effort to adapt the organization and rally the support of workers, middle managers, and union leaders. Drawing on the Saturn and Xerox models, William Hobgood of United Airlines concluded, “If you are ultimately trying to accomplish a complete change, you have to tackle the implementation at every level of an organization.” In a unionized setting, a cultural change involving a new social contract could only be adopted and sustained if it was addressed in every collective bargaining negotiation, in order to support a multi-year plan for implementation and ensure that the resources necessary to realize the change are committed.”

However, Rocheleau cautioned that a new model must also be adaptive to the reigning culture—or it will fail either to be implemented or to survive. “As an experiment, you’re more like a mutant organism that taxes the system. In order to avoid being removed, you have to be more compatible with the host,” he said. In a large organization, the adaptation process would need to be incremental, sustained, and consistent to have a large-scale effect. It would also have to be resilient enough to survive the normal fluctuations in business cycles, the inevitable conflicts and crises that will be encountered, and the expected resistance to cultural change by the people involved.

### 3. Design structures that have staying power.

The group agreed that—for a new social contract to be sustainable in the long-term and in the face of changes in business conditions, key supporters, or leadership—it would need to be adaptive and open for negotiation to adjust to ongoing changes; to contribute to key performance outcomes by demonstrating it is adding value and helping to meet key employee objectives and expectations; and to have built-in mechanisms for employees and managers to resolve differences or disputes that inevitably arise without undermining the process itself.

Productive negotiation is key to the success of any new model—whether these negotiations take on the formal features of collective bargaining or the more informal nature of day-to-day interaction in both union and nonunion settings. In either case, trust will only be gained when channels for debate are open. Saturn’s co-management system, which extends from the strategic to the front-line levels within the organization, is an innovative—but equally controversial—example of enduring mechanisms for employee involvement, voice, informal and formal negotiations, and dispute resolution.

But ultimately, to achieve permanence, a new model must also add value—a return to shareholders, an increase in productivity. “To what extent is a new social contract viable? Does it die with changes in the financial status of the firm? The success of a new contract will depend on its ability to meet *financial and social* obligations,” said Ralph Craviso from Lucent Technologies.

The Lucent case illustrates another point—the tradition of a fixed, long-term contract that developed through collective bargaining over the post-War period is no longer flexible enough to adjust quickly to today’s economic changes. Thus, the Walter Reuther’s concept of the contract as a “living document” needs to become the norm. This notion is what kept the Xerox partnership from deteriorating as new conditions (in some cases bad economic times and in other cases good ones) arose. The parties were able to adjust their agreements as needed to address these new conditions. Again, such flexibility can only be achieved if there is sufficient communication and transparency of the information for all stakeholders involved, as well as the trust required to support renegotiations when conditions change unexpectedly. Clearly, an institution-building

task is once again required to accomplish this level of comfort; the Xerox case, as well perhaps as the Saturn example, offer a few ideas. In both cases, union and employer representatives interact on business issues in a relatively continuous, or at least periodic and timely, fashion.

#### **4. Remember that leadership is important.**

While a focus on structure is necessary for redefining a new social contract, alone it is not sufficient. The importance of leadership on the part of management is critical: every successful innovation hinges on a CEO or top-level official signing on and being willing to make a commitment. Without that leadership, the effort will not happen and might not become sufficiently institutionalized to survive a change in leadership at a later time.

One reason that the Xerox case stands out is that it has endured multiple CEO and union leader successions. In fact, leadership changes are about to challenge the union-management partnership once again; however, both parties are already taking steps to ensure the heir apparent CEO understands the history and achievements of the partnership, engages union leaders in open discussions of his vision and goals, and communicates his hopes for the partnership's future. This rather unique attention to managing leadership transitions may account in part for the longevity of this partnership.

An equivalent level of commitment by union leaders and members is also needed. Some unions have supported these efforts and others have not, and it is this unclear vision or ambivalence within the labor movement that has hindered labor's ability to build leadership capacity to promote and support these types of processes and partnerships. This is a critique of the labor movement. Until a generation of union leaders has internalized the importance of these models, has understood what it takes for a business to be run successfully in this environment, and has the political savvy to manage a democratic institution, the potential of these models is limited.

However, this limitation is being addressed. Building on considerable local union leadership experience in the field, the AFL-CIO has created a unit specifically

charged with developing a clear vision and strategy for workplace democracy and strategic partnerships rooted in the values of the labor movement. The key questions for the future are: How can union officials develop the knowledge about industry and the leadership skills necessary to strike mutually beneficial bargains that would make a new social contract viable and sustainable? How can union members be convinced to trust and invest in that knowledge? (We will be exploring these critical questions at the next meeting of this Working Group.)

## **5. Strengthen and reposition the role of human resources.**

American management has downplayed the strategic role that human resources (HR) could play in reconstructing mutually beneficial employment practices. As I mentioned in the meeting, “We can’t ignore HR’s professional value and power. HR can indicate when a company’s practice isn’t fair, legal, feasible, or sensible. HR can say: ‘You can’t do it that way, not just because a union or government regulation says you can’t, but also because it will destroy the trust we have worked hard to build with our employees.’”

I believe that there needs to be a deeper and more powerful voice within the management structure—one that is equivalent to the financial voice—expressing the notion that good management requires investment in the company’s workforce and community. There is still a critical role for HR and IR professionals within the corporation. These positions have lost power to finance and to line executives running individual business units, particularly as the roles of unions and government have receded, but we need to recreate that power in order to establish and sustain new social contracts that make sense. The key indicators of the relative power of these different management groups are who is involved and who makes the decisions about whether or not work is to be outsourced. The Xerox and Saturn cases demonstrated that HR or IR professionals and union leadership had a voice in these decisions. At Lucent, business unit leaders had greater discretion to act, resulting in considerable tension that is now the subject of active discussion.

## **6. Negotiate the boundaries of the firm and its community and labor market responsibilities.**

In considering new or revised social contracts, it is important to determine which components should be inside or outside of a firm. As suggested above, in these cases, *the biggest common threat to destroying prior social contracts and their concomitant trust is the current trend toward focusing on “core competencies” and outsourcing as much of the remaining work of the firm as possible.* Thus, determining where the boundaries of firms are placed becomes an important part of the negotiation of new social contracts—one few employers wish to negotiate explicitly or share power over. Yet, if this issue represents the critical choice driving employment security and the level of wages and benefits that employees are paid, then it cannot be ignored or left off the table.

Negotiations over these issues could help to determine whether or not, for example, a company like Lucent could—or should—spin off its manufacturing functions. On the other hand, such questions could assist companies like Xerox, Kodak, Saturn, and Lucent—where internalized manufacturing processes help to feed research and development—understand how maintaining but reorganizing production could serve as a key competitive strategy.

Williams followed up these points with two questions: “Should new social contracts explicitly include the idea of community development? Is that commitment reasonable to suggest?” Taken together, the Xerox and Kodak cases highlight how individual firm decisions could have significant effects on the economic infrastructure of their communities. Located in the same town of Rochester, NY, if both companies resort to massive manufacturing layoffs, where will local workers find family-supporting employment? In the growing low-wage service sector? The combined effects of the social contracts at both of these companies could have potentially devastating effects on a local economy. The Working Group agreed that this issue will also be a priority for future discussions.

## **7. Look for potential solutions that lie outside of the organization.**

While the cases focused on the social contract within individual firms, the working group recognized that there are limits to what can be achieved in any specific company, especially given the intense pressures for bottom-line results in today's marketplace. The issue, then, boils down to the following question: What are the limits of individual company-employee social contracts and how do efforts to renegotiate and sustain a new social contract within individual firms relate to the broader set of community and labor market institutions? This concern is less relevant for firms that anticipate or can predict with reasonable certainty that their employment levels will either remain stable or change in an incremental fashion. United and other large companies with relatively stable employment levels, for example, will most likely continue on their current paths—though, no doubt, with significant modifications that depend on the success of both the firm and its industry. However, this level of predictability is less prevalent today than in the past—and, indeed, may be relatively rare. While it is important to examine individual firm practices, it is equally essential to examine how institutions external to the firm can complement existing social contracts or establish explicit relationships where they are non-existent.

As Locke mentioned, given the inherent instability of individual establishments, pinning a “social contract” on any one firm could be a limited notion. “To give multiple stakeholders rights and voice, there could be a more efficient institution outside of the firm. We really need to explore what we mean by that—could it be something sustained at the community level?” Both Xerox and Kodak have demonstrated a willingness to listen to and work with community representatives in the past—whether they are union or non-union groups. What lessons do these cases offer for other communities in similar predicaments?

In some cases, extra-firm solutions could help to recreate a social contract. As Mills asked, “Are there other forms of employment and economic security that can be devised as a result of multi-firm provisions or job creation and economic development efforts beyond one firm?” Is it possible to determine a way to balance internal labor market contracts and relationships outside the firm?

## **8. Include notions of social value in the calculation of value added.**

When comparing companies such as Lucent and its younger but potent competitor, Cisco Systems, the group was struck by the enormous difference in each company's number of employees, their use of integrated versus outsourced manufacturing systems, and the number of dollars spent on pensions and benefits. Margaret Blair of The Brookings Institution suggested that the "social value" maintained by a company like Lucent over its competitor Cisco should be incorporated into a different type of accounting that considers the benefits of an employer's practices to its larger community. "If you take value to shareholders and add it to an expected stream of benefits to employees, there's a different mechanism for how that value is taken into account," said Blair. I agreed with Margaret, adding: "That's a fundamentally different concept of the firm, similar to a stakeholder model—that different objectives are served by the corporation than simply maximizing shareholder value. If we don't join this issue, we won't be able to adequately explore new models for the social contract."

## **Issues for Further Discussion**

These cases and the discussions they generated among the diverse members of the Task Force's Working Group on the Social Contract and the American Corporation suggest two key points on which to base future discussions around rebuilding the social contract in employment.

First, efforts to adapt practices and norms within individual companies are necessary but not sufficient requirements for rebuilding a new social contract at work that fits today's realities. Indeed, we have identified the need for further institutional innovations to support such individual company-employee-union efforts.

Second, efforts within these individual employment relationships must be supplemented with community, labor market, and perhaps industry-level institutional innovations capable of overcoming the inherent limits of individual firm-level efforts. These external institutions may be more important now than in the past, given the changing markets and technologies that limit the promises and commitments that an individual firm can make to its employees.

What these external institutions should be—and how individual firms and unions should relate to or participate in them—are issues we will be discussing in future meetings, Working Papers, and other publications of the Task Force.

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